United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

74-1277 ORIGINAL

To be argued by
GEORGE A. HAHN

In The

United States Court of Appeals

For The Second Circuit

GEORGE FELDMAN, as Trustee in Bankruptcy of Leasing Consultants Incorporated, Bankrupt,

Plaintiff-Appellee,

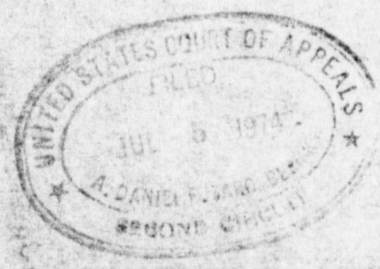
vs.

CHASE MANHATTAN BANK, N.A.,

Defendant-Appellant.

On Appeal from the United States District Court for the Southern District of New York.

BRIEF FOR PLAINTIFF-APPELLEE



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UNITED STATES COURT OF APPEALS

For The Second Circuit

Docket No. 74-1277

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Plaintiff-Appellee,

against

CHASE MANHATTAN BANK, N.A.,

Defendant-Appellant.

ON APPEAL from the UNITED STATES DISTRICT COURT

for the SOUTHERN DISTRICT of NEW YORK

BRIEF FOR PLAINTIFF-APPELLEE

Preliminary Statement

Defendant appeals from an order and judgment entered on January 28, 1974 based upon a decision rendered by Honorable Arnold Bauman, District Judge, United States

District Court, Southern District of New York, in Feldman v. Chase Manhattan Bank, N.A., 368 F. Supp. 1327 (S.D.N.Y. 1974).

Statement of Case

This is an action by a trustee in bankruptcy using his status under §70c of the Bankruptcy Act, 11 U.S.C. §110c, to invalidate, pursuant to §503c of the Federal Aviation Act of 1958, 49 U.S.C. §1403c, the assignment of an aircraft lease made by the bankrupt lessor to defendant bank, and to recover the post bankruptcy proceeds of the assigned lease. Defendant asserted by way of affirmative defense that the trustee should be equitably estopped from asserting the invalidity of the assignment. By way of counterclaim, defendant sought to set-off the proceeds of the trustee's transfer to the lessee of his right, title and interest in the leased aircraft, and sought damages for an alleged interference with the defendant's collateral.

Plaintiff moved for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure (A18-A46) and defendant cross-moved for summary judgment (A47-A55). The court, Bauman, J., granted summary judgment for the plaintiff-trustee, finding no genuine issues as to material facts (A70). Judgment was thereafter entered in favor of plaintiff and against defendant on January 28, 1974. Defendant is appealing from that judgment.

The Facts

A. Regarding The Complaint

On August 18, 1970, Leasing Consultants Incorporated ("LCI") filed a petition for an arrangement under Chapter XI of the Bankruptcy Act in the United States District Court for the Eastern District of New York. LCI was thereafter adjudicated a bankrupt on October 16, 1970 and George Feldman, the plaintiff-appellee, was appointed and qualified as trustee.

LCI was in the lease/finance business, and in 1967 had purchased a Cessna 411 aircraft and leased it to Zinke-Smith, Inc., presently known as Devcon International Corporation (hereinafter "Devcon"). The lease agreement (A3 to 7, A40) provided for monthly payments over a five year period. LCI may have orally agreed to sell the Cessna to Devcon at the end of that period for a nominal sum.

Thereafter, in July of 1967, LCI negotiated a secured loan with Chase Manhattan Bank, N.A. ("Chase"). In this transaction, LCI gave Chase two security agreements. They were denominated as an "Assignment" (A8 to A9) and as a "Chattel Mortgage and Security Agreement" (A53 to A54) (hereinafter the "Mortgage"). The "assignment" gave Chase a chattel paper security interest in the Devcon lease and the "mortgage" gave Chase a security interest in the lease reversion, if any. Chase filed the "mortgage" with the Administrator of the Federal Aviation Administration (hereinafter the "Administrator") but failed to file the "assignment" (A65).

B. Regarding Chase's Affirmative Defense and Counterclaim

Following the bankruptcy, in October of 1971, Devcon attempted to exercise its oral purchase option (A62). The trustee advised Devcon and Chase that he had no record of a purchase option agreement (A63).

Early in 1972, Chase advised the trustee that Devcon had stopped making its lease payments and that Chase intended to repossess the Cessna under its mortgage (A59). The Trustee tried without success to dissuade Chase from seizing the Cessna (A60).

After Chase seized the Cessna, it advertised its sale at public auction (A51, A60). On March 20, 1972, the eve of the sale, Devcon commenced an action in the United States District Court for the Southern District of Florida to enjoin the sale; to obtain reformation of the lease to include a nominal purchase option; and for specific performance of the lease as reformed. Chase, its auctioneer and LCI were named as parties defendant in the action (A25). The court enjoined the sale.

Settlement discussions followed. At a meeting on April 13, 1972, the attorneys for Chase and Devcon discussed the possibility of a settlement between themselves whereby Devcon would give Chase $18,000.00 in payment of accrued lease payments and expenses, and general releases would be exchanged. After participating in the initial discussions at the meeting of April 13, 1972, counsel for the trustee withdrew in disagreement, making it clear that the Trustee would not be a party to any settlement (A60).

In May of 1972, Devcon filed an amended complaint (A33-A40) in the Florida District Court naming the Trustee as a party defendant in lieu of LCI, and adding a cause of action against Chase for wrongful seizure of the Cessna (A36-A37). The proposed settlement between Devcon and Chase appeared doubtful.

In December of 1972, the Florida suit was set down for trial. In preparing for trial, the Trustee's counsel noted that the "assignment" had not been recorded, and that it accordingly appeared vulnerable to attack by the Trustee (A60-A61). Trustee's counsel immediately advised Chase (A61).

At that time, the settlement between Chase and Devcon had not yet been consummated (A61).

A stipulation of dismissal (A41-A43) dated January 23, 1973, was finally executed by Chase and Devcon and an order of dismissal entered on February 5, 1973 (A44). In March of 1973, Devcon's suit to reform the lease to include a nominal purchase option went to trial. It was settled prior to a verdict (A45-A46). Under the settlement the Trustee received $20,000.00 in return for his right, title and interest in the Cessna. This suit was commenced shortly thereafter.

Point I

SECURITY INTERESTS IN AIRCRAFT LEASE CHATTEL PAPER CAN ONLY BE PERFECTED BY FILING THE SECURITY AGREEMENT WITH THE ADMINISTRATOR

The controversy, as defined by appellant Chase, is concerned with whether the assignment (A8 to A9) of the Devcon lease by LCI to Chase is a conveyance subject to recordation. Both parties acknowledge that Congress directed the Administrator to establish a system for the recordation of "any conveyance which affects the title to, or any interest in, any civil aircraft of the United States," Federal Aviation Act of 1958, §503(a)(1), 49 U.S.C. §1403(a)(1); and that no conveyance which should be recorded in that system, and is not recorded, is valid against third persons without actual notice such as a trustee in bankruptcy. Federal Aviation Act of 1958 §503(c), 49 U.S.C. §1403(c).

It is admitted that the "assignment" constituted a security agreement covering chattel paper (A21, A49). Chattel paper is a classification of collateral created by the Uniform Commercial Code. U.C.C.§9-105(b) defines "chattel paper" as:

> "... a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods...."

Traditionally chattel paper includes chattel mortgages, conditional sale contracts and leases, when these agreements are used as collateral in a secured transaction. See Official Comment to U.C.C. §9-308. For the purpose of the Trustee's motion for summary judgment, the court treated the chattel paper as a true lease.*

The assignment of a chattel mortgage comes under the statutory definition of "conveyance", to wit:

> " 'Conveyance' means a bill of sale, contract of conditional sale, mortgage, assignment of mortgage, or other instrument affecting title to, or interest in, property." Federal Aviation Act of 1958 §101(17), 49 U.S.C. §1301(17). (Emphasis supplied.)

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* Plaintiff-appellee believes that the chattel paper is in fact a conditional sale contract as defined at 49 U.S.C. §1301(16)(b). But this creates a triable issue of fact as to the existence of a purchase option. If the court determines that the assignment of a lessor's interest under an aircraft lease is not a recordable conveyance, but that the assignment of a vendor's interest under a contract of conditional sale is a recordable conveyance, the cause must be remanded for trial.

If the chattel paper were a conditional sale contract,* then its assignment would come under a further definition promulgated by the Administrator under the authority of Federal Aviation Act of 1958 §503(g), 49 U.S.C. §1403(g), to wit:

> "This subpart applies to the recording of the following kinds of conveyances:
> (a) A bill of sale, contract of conditional sale, assignment of an interest under a contract of conditional sale, mortgage, assignment of mortgage, lease, equipment trust, notice of a tax lien, or other instrument affecting title to, or any interest in, aircraft." 14 C.F.R. §49.31(a). (Emphasis supplied.) See also 14 C.F.R. §49.17(d)(2).

But, just as the statutory definition of "conveyance" is expressly non-exclusive, covering: "...other instrument[s] affecting title to, or interest in, property....," leading to the extended definition found in the Regulations,** the Regulations were not intended to be exclusive. They too refer to "... any other instruments affecting title to, or any interest in, aircraft...." It follows that the assign-

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* See previous footnote.

** See 14 C.F.R. 49.31(2), supra

ment of a lessor's interest under a lease affects an interest in the Cessna aircraft. Using Judge Bauman's analysis:

> "It would seem incontrovertible that the statutory language "conveyance which affects ... any interest in" an airplane should encompass an assignment of a lease. Clearly the present possessory right and the entitlement to rentals conferred by a lease agreement are property "interests" as the term has been generally understood; less than "title" perhaps, but "interests" nonetheless. It then follows that assigning a lease "affects" the lessor's interest by transferring its primary incident, the right to receive rentals." (A68).

In terms of the development of the chattel paper concept under the Code, there is no reasonable basis to distinguish between the clearly mandated recording of assignments of aircraft mortgages and assignments of aircraft conditional sale contracts on the one hand and the assignment of an aircraft lease. This is particularly true since all three forms of chattel paper are subject to recordation. See 14 C.F.R. §49.31(a).* Congress clearly intended that all instruments affecting title to or interests in aircraft be recorded so that anyone dealing with an aircraft can rely on the record to reveal all enforceable encumbrances on the aircraft and the holders of such encumbrances.

Chase relies heavily on District Judge Neaher's decision in Industrial National Bank of Rhode Island v. Butler Aviation International, Inc., 370 F. Supp. 1012 (E.D.N.Y. 1974), a case involving an aircraft priority dispute between a bailee's possessory lien and a recorded chattel mortgage. That case is not controlling because a bailee's possessory lien

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* Under 14 C.F.R. §49.31(a) contracts of conditional sale, mortgages and leases are all "conveyances."

is not witnessed by an instrument. Id., 370 F.Supp. at 1017.* As a matter of policy it is unreasonable to require airports renting parking space or mechanics making repairs to check the record and obtain an undertaking or subordination agreement from all lien holders of record before supplying their services. On the other hand, when dealing with rights created by written instruments, there is no sound reason to excuse recordation. Furthermore, there is no rational basis for differentiating between different kinds of chattel paper for recordation purposes, particularly in view of the difficulty in distinguishing between a true lease and a lease intended as a security device. In re Leasing Consultants Incorporated, 486 F.2d 367 (2d Cir. 1973).

Judge Neaher in fact supports Judge Bauman's analysis in the instant case. Judge Neaher determined that the bailee's possessory lien does not involve title to or any interest in the aircraft, Id., 370 F. Supp. at 1017, while Judge Bauman found that the assignment of a lease does.

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* Chase also refers to Southern Jersey Airways, Inc. v. National Bank of Secaucus, 108 N.J.Super. 369, 261 A.2d 399 (App. Div. 1970), relied upon by Judge Neaher, where the court applied New Jersey law to hold a mechanic's possessory lien superior to a federally recorded chattel mortgage.

Judge Neaher found that

> "...failure to federally record a recordable instrument would entail the specific consequences declared by §1403(c), but no other...." Id., 370 F.Supp. at 1017.

Judge Bauman applied those specific consequences against Chase, i.e., he held the conveyance invalid as to third persons without notice, such as a §70c trustee.

As found by Judge Bauman, the assignment of the Devcon lease is a recordable instrument. The consequences of Chase's failure to record this assignment is its invalidity against the Trustee using his status under §70c of the Bankruptcy Act, 11 U.S.C. §110c. This renders Chase's chattel paper security interest unperfected and entitled the Trustee to recover all post-petition proceeds of the Devcon lease. Accordingly, judgment was properly granted in favor of plaintiff Trustee.

Point II

THE CODE RECOGNIZES THE SUPREMACY OF THE FEDERAL STATUTE

Article 9 of the Uniform Commercial Code, by its express provisions, does not apply to secured transactions involving aircraft. Section 9-104(a) states:

> "This Article does not apply...
> "(a) to a security interest subject to any statute of the United States such as the Ship Mortgage Act, 1920, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property;..."

While Article 9 permits the use of permissive filing to perfect chattel paper security interests, U.C.C. §9-304(1), the filing provisions do not apply to aircraft transactions. U.C.C. §9-302 provides that:

> "(3) The filing provisions of this Article do not apply to a security interest in property subject to a statute...
> "(a) of the United States which provides for a national registration or filing of all security interests in such property; ...
> "(4) A security interest in property covered by a statute described in subsection (3) can be perfected only by registration or filing under that statute or by indication of the security interest on a certificate of title or a duplicate thereof by a public official." (Emphasis supplied.)

Inasmuch as the Federal Aviation Act requires recordation of all security interests in or relating to aircraft, Chase's failure to comply with the filing requirements of that statute is fatal.

Point III

THERE IS NO ESTOPPEL

Chase's "seventh affirmative defense" alleges that the Trustee's failure to contest the validity of LCI's assignment of the Devcon lease prior to the time that Chase seized the Cessna aircraft caused Chase to change "its position by incurring great financial expense and exposing itself to enormous legal liability" (A12). Thus Chase argues:

> ".... Had the trustee given notice of its claim to the rental payment, which Chase was endeavoring to collect by said process, and not consented thereto, Chase would not have attempted to recover the moneys due it by the exercise of such rights but merely allowed the trustee to take possession of the aircraft as owner, subject to the rights of Chase as a secured creditor. Because plaintiff did not object to the attempted sale, Chase changed its position, incurring substantial litigation expenses and other charges, and compromising its interests under the chattel mortgage and security agreement pursuant to the settlement stipulation with Devcon (A41)...." Appellant's Brief at 12.

But Chase's difficulties[1] do not arise from its seizure of the Cessna unless they are traced to Chase's alleged mis-

[1] While paragraph 13 of Chase's Answer (A12) alleges that "...Chase changed its position by incurring great financial expense and exposing itself to enormous potential legal liability....", Chase's Rule 9-g statement is devoid of factual allegations in support of that allegation.

conduct in conducti_g the seizure.[2] Chase's difficulties can be traced squarely to its settlement with Devcon by which it surrendered its chattel mortgage interest in the lease reversion.

The only apparent rationale for Chase's releasing its interest in the valuable reversion,[3] is that Chase faced a real exposure due to its alleged failure to give Devcon notice of lease termination prior to its seizure of the Cessna.[4] A proper foreclosure does not expose a mortgagee to potential legal liability.

Since Chase's difficulties are traceable to its settlement with Devcon, it is relevant that the trustee notified Chase of his claim prior to consummation of the settlement (A61).

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[2] Devcon's amended complaint (A33-A40) charges Chase with wrongful seizure of the Cessna, alleging that: Chase "...violated and failed to comply with the provisions and terms of the lease involved in this law suit by seizing the aforedescribed Cessna aircraft from Plaintiff without first providing notice in writing to the Plaintiff, Devcon, terminating the lease." (A36).

[3] The Cessna was worth in excess of $50,000.00 (A51).

[4] See paragraph 17b of the lease (A39).

While the whole issue of the trustee's consent or lack of objection to Chase's seizure of the Cessna is clearly irrelevant, the record does not even indicate such consent. The reply affidavit of Daniel A. Zimmerman (A58-A61) clearly contradicts this statement:

> "10. Despite the apparent validity of the chattel mortgage, I advised Chase not to sell the airplane on the basis that Chase's interest in the aircraft was nominal compared to the trustee's interest. This was because Chase was holding a reserve account in excess of $11,000.00 against a loan balance of approximately $15,000.00". (A60).

Though Chase had an opportunity to contradict this statement, it did not.

Finally, if the Trustee had attacked the validity of the assignment at that time and recovered judgment for the post-petition rentals collected by Chase, Chase would have been compelled to foreclose under its chattel mortgage on the lease reversion, its only collateral. Chase would have seized the Cessna, as it did. Chase would then have attempted to sell the Cessna, as it did. An earlier assertion of the invalidity of the assignment would thus not have altered Chase's conduct, but would have been calculated to produce the same result.

Point IV

CHASE'S RECORDED CHATTEL MORTGAGE IS IRRELEVANT AND CHASE'S COUNTERCLAIM WAS PROPERLY DISMISSED

Chase has no standing to assert a counterclaim based upon its status as a mortgagee because it assigned its mortgage interest to Devcon. Hertzmann v. Willys-Overland Motors, 68 F. Supp. 873 (D.C.N.Y. 1946). As stated by Judge Bauman:

> "Chase's counterclaim for the market value of the airplane must fail since Chase assigned all of its interest in the mortgage to Devcon prior to the trustee's sale. In short, since Chase had divested itself of its reversionary interest under the chattel mortgage before the sale, it consequently suffered no resulting loss as a result of the sale." (A69).

But even if Chase had not assigned its mortgage interest to Devcon, its counterclaim would fail as a matter of fact and as a matter of law. The Trustee sold only his right, title and interest in the Cessna aircraft. (A24, A25). This form of transfer is subject to all existing liens and encumbrances and was intended to give Devcon any

rights to the Cessna aircraft not already owned by it. Devcon already possessed its leasehold interest and Chase's mortgage interest. On its face this transfer does not interfere with Chase's alleged mortgage interest. The trustee transferred what was his, and nothing more. Furthermore, the Federal Aviation Act of 1958 §503(d), 49 U.S.C. §1403(d) provides:

> "Each conveyance or other instrument recorded by means of or under the system provided for in subsection (a) or (b) of this section shall from the time of its filing for recordation be valid as to all persons without further or other recordation ...."

A properly filed conveyance is valid as to all persons from the time of its filing. By virtue of this statutory section a conveyance by the Trustee could not cut off Chase's interest under the recorded chattel mortgage and therefore could not interfere with Chase's collateral.

Conclusion

As demonstrated, the judgment below was correct and proper. The judgment appealed from should be affirmed.

Respectfully submitted,

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A 202 Affidavit of Personal Service of Papers H LUTZ APPELLATE PRINTERS INC.

U.S. COURT OF APPEALS:SECOND CIRCUIT

Index No.

FELDMAN,
Plaintiff-Appellee,

against

CHASE MANHATTAN BANK,
Defendant-Appellant.

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF NEW YORK *ss.:*

I, James Steele, *being duly sworn,*

deposes and says that deponent is not a party to the action, is over 18 years of age and resides at

250 West 146th Street, New York, New York

That on the 5th *day of* July *19* 74 *at* 1 Chase Manhattan Plaza, New York

deponent served the annexed Appellee's Brief *upon*

Milbank, Tweed, Hadley & McCloy-Attorneys for Appellant

the *in this action by delivering a true copy thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the* Attorney(s) *herein,*

James Steele

Print name beneath signature

JAMES STEELE

Sworn to before me, this 5th
day of July *19* 74

Robert T. Brin

ROBERT T. BRIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 31 - 0418950
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MARCH 30, 1975